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No. 87-600

In the Supreme Court of the United States

OCTOBER TERM, 1987

THE VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL., PETITIONERS

v.

BEVERLY J. OTTO, INDIVIDUALLY, AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF FOR THE NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF FOR THE NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS AS AMICUS CURIAE

Pursuant to Rule 36 of the Rules of this Court, the National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") requests leave to file the accompanying brief as *amicus curiae* in support of petitioners. Counsel for petitioners has consented to the filing of this *amicus curiae* brief, but counsel for respondent has declined consent.

NOLHGA consists of all of the operating life and health insurance guaranty associations that have been established by state laws enacted in 40 states, including Illinois and Texas. An insurance guaranty association assumes the insurance obligations of insolvent or financially impaired insurance companies. By ensuring the

payment of benefits and the continuation of coverage for policyholders, NOLHGA's members guarantee essential health benefits and retirement income for millions of people.

The ability of state guaranty associations to protect consumers of insurance will be substantially and adversely affected by the decision that petitioner The Variable Annuity Life Insurance Company ("VALIC") asks this Court to review. The holding of the court of appeals that the excess interest fixed annuity issued by VALIC was a security under the federal securities laws increases the prospect of insurance company insolvencies and at the same time threatens to harm the ability of guaranty associations to pay the claims of an insolvent insurer's policyholders.

Accordingly, NOLHGA submits this brief to explain the substantial practical importance to guaranty associations, and to the policyholding public they protect, of the question presented in VALIC's petition for certiorari. NOLHGA has participated as *amicus curiae* in other judicial proceedings to represent the interests of its member associations.

For the foregoing reasons, the motion of NOLHGA for leave to file the accompanying brief as *amicus curiae* in support of petitioners should be granted.

Respectfully submitted.

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BRIEF FOR THE NATIONAL ORGANIZATION OF LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATIONS AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICUS CURIAE

The National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") consists of all of the life and health insurance guaranty associations that have been established under state statutes enacted in 40 states. NOLHGA's interest in the question presented here is set forth in the accompanying motion for leave to file this brief as *amicus curiae* in support of petitioners.

ARGUMENT

THE DECISION OF THE COURT OF APPEALS THREATENS TO INJURE CONSUMERS OF INSURANCE BY IMPAIRING THE OPERATIONS OF STATE GUARANTY ASSOCIATIONS

For the reasons stated in the petition for certiorari, NOLHGA agrees that the decision of the court of appeals in this case is both important and erroneous. Of particular concern to NOLHGA is that the decision may adversely affect the ability of state life and health insurance guaranty associations to protect consumers of insurance—the very group that the court of appeals sought to protect.

A. Operations of State Guaranty Associations.

The insurance codes of 40 states, including Illinois and Texas, provide for an insurance guaranty association to pay benefits and continue the coverage for insurance and annuity policyholders of financially troubled insurers. This guaranty system safeguards the interest of insurance consumers by assuring them that, subject to statutory limits, the vital protections they have purchased will remain in force despite a failure in the financial condition of the issuing company. In this way, state insurance guaranty associations reinforce the long-term safety and reliability of insurance products.

The life and health insurance guaranty association in each state is composed of all insurers that write life or health insurance or annuities in the state. If a member company becomes insolvent, the association is required to guarantee, assume, or reinsure all of the member's contracts that are covered by the guaranty statute and to assure payment of all covered claims of the member's policyholders. In addition, the guaranty association may

guarantee, assume, or reinsure contracts, or pay claims, if a member company becomes financially "impaired." The association funds the obligations it assumes from insolvent or impaired insurers primarily by assessments levied on its other member insurance companies.

B. Guaranty Coverage Will Be Adversely Affected.

The state statutes prescribing the duties and powers of guaranty associations are derived from one of three versions of the Model Life and Health Insurance Guaranty Association Act ("Model Act") adopted by the National Association of Insurance Commissioners ("NAIC"). Each of these versions provides that the Model Act "shall not apply" to any "part" or "portion" of a life insurance or annuity policy "under which the risk is borne by" the policyholder; the two later versions also make specific provision that the Act does not apply to any portion of a variable policy "not guaranteed" by the insurer. See Model Act § 3, 1986 NAIC Model Regulation Svce. 520-1, 520-2; 1977 NAIC Model Regulation Svce. 520-1, 520-2; 1 NAIC Proceedings 160, 161 (1971).

NOLHGA is unaware of any judicial authority construing this language. However, the court of appeals' decision raises serious questions of whether this "risk" limitation would affect coverage under the state statutes of excess interest fixed annuities as well as other interest-sensitive annuity and life insurance products, because a security is generally understood to be an instrument the value of which is not "guaranteed," and under which "the risk is borne" by the contract holder. At the least, there is a substantial possibility that the excess interest portion of the contract (including, potentially, accrued excess interest payments that have been declared and credited to the policyholders) would be removed from the statutory guaranty. By depriving policyholders of guaranty protections that both the insurance industry and consumers have heretofore understood to be applicable,

the Seventh Circuit's decision will be detrimental to the interest of policyholders in being assured that their insurance and annuity benefits will be available if and when they are needed. To give policyholders that peace of mind is the fundamental purpose of insurance.

The dangers posed to policyholders by a financially impaired or insolvent insurer are well illustrated by the recent example of the insurance subsidiaries of the Baldwin United Corporation, which when it became insolvent in 1983 was the largest insolvency in U.S. history. If even a portion of the interest credited to holders of Baldwin's single premium deferred annuities had fallen outside the state guaranty statutes, on the ground that the risk under these interest sensitive "securities" was borne by the policyholder, approximately 167,000 annuity holders would have lost substantial guaranty protections of accumulated interest.

C. Insolvency Risks Could Be Increased.

The decision of the court of appeals also could have other adverse consequences for insurance guaranty programs and policyholders. As explained in the petition (at 12-13), issuers of excess interest fixed annuities would be exposed to liability for damages and to rescission of the contracts (with a refund for premiums paid) under the federal securities laws. If such unanticipated liabilities occur, they could lead to the insolvency or impairment of insurers and thereby impose an additional burden on guaranty associations. Moreover, rescission of outstanding contracts would skew the actuarial and mortality assumptions that underlie an insurer's portfolio of policies; this would be especially problematic, and would further threaten the financial health of insurance companies, because policyholders who decide to retain their policies rather than seek rescission are likely to be worse insurance risks and therefore disproportionately costly to the insurer.

D. Guaranty Associations' Assessment Ability May Be Impaired.

In addition, if a contract is excluded (in whole or in part) from the guaranty statute, the attendant premiums would not be included in the member insurance company's base on which the guaranty association makes assessments to fund the insurance obligations it assumes. *See* Model Act §§ 5(9), 9 (assessments are based on member premiums for covered contracts). The Seventh Circuit's ruling thus introduces a significant uncertainty over the proper assessment base and raises the possibility that guaranty associations would face a substantially diminished ability to pay claims. This concern would be exacerbated to the extent that insurance companies could seek a refund of assessments already paid on the ground that the premium base included contracts that, under the court of appeals' decision, were securities and not insurance covered by the guaranty statute.

In sum, NOLHGA submits that the decision of the court of appeals in this case represents a threat to the proper functioning of its member state guaranty associations and to the interests of policyholders that the guaranty statutes are intended to protect. Those disturbing consequences demonstrate the need for this Court to review and reverse the ruling below.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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